(2) At a minimum, the corporate credit union must maintain:

(i) A justification for each approved credit limit;

(ii) Disclosure documents, if any, for all instruments held in portfolio. Documents for an instrument that has been sold must be retained until completion of the next NCUA examination; and

(iii) The latest available financial reports, industry analyses, internal and external analyst evaluations, and rating agency information sufficient to support each approved credit limit.

[75 FR 64841, Oct. 20, 2010, as amended at 75 FR 71528, Nov. 24, 2010]

EFFECTIVE DATE NOTE: At 76 FR 79533, Dec. 22, 2011, §704.6 was amended by removing paragraphs (c)(3) and (f)(4) and adding paragraph (h), effective Jan. 23, 2012. For the convenience of the user, the added text is set forth as follows:

§ 704.6 Credit risk management.

* * * * *

(h) Requirements for investment action plans. An investment is subject to the requirements of §704.10 of this part if:

(1) An NRSRO that rates the investment downgrades that rating, after purchase, below the minimum rating requirements of this part; or

(2) The investment is part of an asset class or group of investments that exceeds the issuer, sector, or subsector concentration limits of this section. For purposes of measurement, each new credit transaction must be evaluated in terms of the corporate credit union's capital at the time of the transaction. An investment that fails a requirement of this section because of a subsequent reduction in capital will be deemed nonconforming. A corporate credit union is required to exercise reasonable efforts to bring nonconforming investments into conformity within 90 calendar days. Investments that remain nonconforming for more than 90 calendar days will be deemed to fail a requirement of this section and the corporate credit union will have to comply with §704.10 of this part.

§ 704.7 Lending.

(a) *Policies.* A corporate credit union must operate according to a lending policy which addresses, at a minimum:

(1) Loan types and limits;

(2) Required documentation and collateral; and

(3) Analysis and monitoring standards.

(b) *General.* Each loan or line of credit limit will be determined after analyzing the financial and operational soundness of the borrower and the ability of the borrower to repay the loan.

(c) *Loans to members*—(1) *Credit unions.* (i) The maximum aggregate amount in unsecured loans and lines of credit to any one member credit union, excluding pass-through and guaranteed loans from the CLF and the NCUSIF, must not exceed 50 percent of capital.

(ii) The maximum aggregate amount in secured loans and lines of credit to any one member credit union, excluding those secured by shares or marketable securities and member reverse repurchase transactions, must not exceed 100 percent of capital.

(2) *Corporate CUSOs.* Any loan or line of credit must comply with §704.11.

(3) *Other members.* The maximum aggregate amount of loans and lines of credit to any other one member must not exceed 15 percent of the corporate credit union's capital plus pledged shares.

(d) *Loans to nonmembers*—(1) *Credit unions.* A loan to a nonmember credit union, other than through a loan participation with another corporate credit union, is only permissible if the loan is for an overdraft related to the providing of correspondent services pursuant to §704.12. Generally, such a loan will have a maturity of one business day.

(2) *Corporate CUSOs.* Any loan or line of credit must comply with §704.11.

(e) *Member business loan rule.* Loans, lines of credit and letters of credit to:

(1) Member credit unions are exempt from part 723 of this chapter;

(2) Corporate CUSOs are not subject to part 723 of this chapter.

(3) Other members not excluded under §723.1(b) of this chapter must comply with part 723 of this chapter unless the loan or line of credit is fully guaranteed by a credit union or fully secured by U.S. Treasury or agency securities. Those guaranteed and secured loans must comply with the aggregate limits of §723.16 but are exempt from the other requirements of part 723.

(f) *Participation loans with other corporate credit unions.* A corporate credit union is permitted to participate in a loan with another corporate credit union provided the corporate retains an interest of at least 5 percent of the face amount of the loan and a master participation loan agreement is in place before the purchase or the sale of a participation. A participating corporate credit union must exercise the same due diligence as if it were the originating corporate credit union.

(g) *Prepayment penalties.* If provided for in the loan contract, a corporate credit union is authorized to assess prepayment penalties on loans.

[62 FR 12938, Mar. 19, 1997, as amended at 64 FR 57365, Oct. 25, 1999; 67 FR 65655, Oct. 25, 2002; 68 FR 56550, Oct. 1, 2003; 75 FR 34621, June 18, 2010]

§ 704.8 Asset and liability management.

(a) *Policies.* A corporate credit union must operate according to a written asset and liability management policy which addresses, at a minimum:

(1) The purpose and objectives of the corporate credit union's asset and liability activities;

(2) The maximum allowable percentage decline in net economic value (NEV), compared to base case NEV;

(3) The minimum allowable NEV ratio;

(4) Policy limits and specific test parameters for the NEV sensitivity analysis requirements set forth in paragraphs (d), (e), and (f) of this section;

(5) The modeling of indexes that serve as references in financial instrument coupon formulas; and

(6) The tests that will be used, prior to purchase, to estimate the impact of investments on the percentage decline in NEV compared to base case NEV. The most recent NEV analysis, as determined under paragraph (d)(1)(i) of this section may be used as a basis of estimation.

(b) *Asset and liability management committee (ALCO).* A corporate credit union's ALCO must have at least one member who is also a member of the board of directors. The ALCO must review asset and liability management reports on at least a monthly basis. These reports must address compliance with Federal Credit Union Act, NCUA Rules and Regulations (12 CFR chapter VII), and all related risk management policies.

(c) *Penalty for early withdrawals.* A corporate credit union that permits early certificate/share withdrawals must assess market-based penalties sufficient to cover the estimated replacement cost of the certificate redeemed. This means the minimum penalty must be reasonably related to the rate that the corporate credit union would be required to offer to attract funds for a similar term with similar characteristics.

(d) *Interest rate sensitivity analysis.* (1) A corporate credit union must:

(i) Evaluate the risk in its balance sheet by measuring, at least quarterly, including once on the last day of the calendar quarter, the impact of an instantaneous, permanent, and parallel shock in the yield curve of plus and minus 100, 200, and 300 BP on its NEV and NEV ratio. If the base case NEV ratio falls below 3 percent at the last testing date, these tests must be calculated at least monthly, including once on the last day of the month, until the base case NEV ratio again exceeds 3 percent;

(ii) Limit its risk exposure to levels that do not result in a base case NEV ratio or any NEV ratio resulting from the tests set forth in paragraph (d)(1)(i) of this section below 2 percent; and

(iii) Limit its risk exposures to levels that do not result in a decline in NEV of more than 15 percent.

(2) A corporate credit union must assess annually if it should conduct periodic additional tests to address market factors that may materially impact that corporate credit union's NEV. These factors should include, but are not limited to, the following:

(i) Changes in the shape of the Treasury yield curve;

(ii) Adjustments to prepayment projections used for amortizing securities to consider the impact of significantly faster/slower prepayment speeds; and

(iii) Adjustments to volatility assumptions to consider the impact that changing volatilities have on embedded option values.

(e) *Net interest income modeling.* A corporate credit union must perform net interest income (NII) modeling to project earnings in multiple interest rate environments for a period of no less than 2 years. NII modeling must,